

Outside Counsel

New Risks Facing Companies Operating in China and Hong Kong

If a military conflict over the Taiwan Strait occurs, in addition to the resulting global instability, a host of complex legal issues will need to be confronted. Supply chain and other contractual relationships will be immediately impacted. Given Russia's invasion of Ukraine, and the announcement of the "no-limit" close relationship between China and Russia, this eventuality should no longer be viewed as remote or hypothetical. The impact of such a conflict would be further complicated by the ever-evolving situation in Hong Kong, a major center for international finance and dispute resolution. International businesses and their attorneys would be well served by considering now the



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substantive and procedural challenges these matters present.

Developments in the PRC

Last month, the Chinese Leader Xi Jinping signed into effect a new military order containing regulations that govern the use of the People's Liberation Army (PLA) in "military operations other than war." While the full text of the regulations has not been published, according to PRC State media, "*the [regulations] will standardize, and provide the legal basis for Chinese troops to carry out missions like disaster relief, humanitarian aid,*

escort, and peacekeeping, and safeguard China's national sovereignty, security and development interests." What caught the readers' eye is the mentioning of both military operations and the safeguarding of China's national sovereignty and security. The use of the term "military operation" by Xi coincides with how Russian President Putin described the invasion of Ukraine. In other words, if the PLA were to invade Taiwan or conduct military operations over the Taiwan Strait or the South China Sea, it would not be regarded as an "act of war" from the Chinese perspective, but rather a special military operation entirely within China's domestic territory aimed "*at safeguarding national sovereignty and security.*" What's more, at about the same time, China's Foreign Ministry announced that the PRC has sovereignty, sovereign rights

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and jurisdiction over the Taiwan Strait and called it “*a false claim when certain countries call the Taiwan Strait international waters.*” This further changes the political as well as the legal landscape for companies operating in the Greater China region.

‘Act of War’?

Most commercial contracts and insurance policies have exclusionary clauses dealing with the parties’ legal relationship in the event of an “act of war.” These standard clauses typically deal with situations in the event of wars, invasions, insurrections and revolutions. After Sept. 11, 2001, these exclusionary clauses were expanded to include terrorist acts caused by private individuals and organizations. In a typical contract, an “act of war” is usually defined as any act occurring in the course of a declared war or an armed conflict, whether or not war has been declared, between two or more nations. Some contracts or statutes may carry more extensive definitions, but many do not go beyond the basic common law understanding of an “act of war.” International laws under the United Nations mechanism would be unhelpful on this question, as China (and Russia) would veto any resolu-

tion under Article 39 of the UN Charter. Notably, Taiwan is not regarded as a sovereign nation state.

If the PRC undertakes special military operations over the Taiwan Strait or the South China Sea, international trade and supply chains would be severely affected. According to the United Nations, 60% of maritime trade passes through Asia, with the

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South China Sea carrying an estimated one-third of global shipping. Taiwan is not regarded by the United States (nor the EU and UK) as a sovereign nation due to the “One China” policy. Under the new regulations signed by Xi, the use of PLA forces over Taiwan would arguably not be regarded as an “act of war,” but a special military operation purely domestic and internal within China. Chinese counterparties would surely take this stance if it benefits them before a tribunal. This claim may now have legal backing under Chinese law. If the operative provisions of a contract are governed by Chinese law, this presents a serious legal

problem for the foreign party in the event of a military conflict.

Most people think of “war” in terms of a large scale military invasion scenario. In the case of a military conflict over the Taiwan Strait, security experts are already pointing to a whole range of options which are open to Xi, including the partial taking over of Taiwan’s outlying Matsu islands, physical blockade, embargo, cybersecurity attack, and the sabotaging of undersea internet cables. As with Ukraine, if United States and EU governments are to sanction China over its actions, China has laid the groundwork for its response by passing the Anti-Foreign Sanctions Laws in 2021, which among other things includes the confiscation of foreign assets on PRC soil. Further, The Financial Times reported that in April of this year, the top banking officials in China called a special meeting to demand that all Chinese banks take measures to safeguard assets in the event of potential western sanctions.

These complex scenarios may overlap with one another. When combined with the uncertain status of Taiwan under international law, these factors create a host of legal questions that may not be fully answered by the text of most

standard “act of war” exclusionary clauses. International companies and in-house counsel should review their Greater-China region related contracts and legal relationships with these specific issues in mind.

Hong Kong’s National Security Law

The forum for resolving disputes pertaining to “act of war” clauses presents additional challenges. Many companies who operate in the Greater-China region use Hong Kong as an international arbitration center. In 2020, Beijing imposed the National Security Law (NSL) on Hong Kong, which substantially changes the legal landscape of the former British Colony. Basic rights once guaranteed under the City’s mini constitution are now overridden by the NSL. The independent authority of the Hong Kong courts have been substantially undermined by the law’s many provisions. Article 47 of the NSL empowers the Chief Executive of Hong Kong to certify any matter to be of “national security and a state secret.” This certification is binding on the Hong Kong courts. No private party can question the use of such power by the Hong Kong government.

Article 47 applies to any court

proceedings in Hong Kong, potentially including the enforcement of an arbitral award. Article 6(2) of the NSL is broad enough to cover an arbitration tribunal, whether seated in Hong Kong or elsewhere. Article 38 gives the NSL global jurisdiction over any person whether in or outside of Hong Kong, irrespective of whether that person is a Hong Kong resident. The NSL prevails over all other local laws in Hong Kong, including the Arbitration Ordinance which is the main legislation governing Hong Kong arbitrations.

In addition, “national security” under PRC laws encompasses everything from economic security, technological security, financial security, data security to cultural security. Any commercial contracts that deal with major transactions or economic areas could fall into the realms of “national security,” whether intended to or not by the parties. The PRC State or the Hong Kong government could intervene in a litigation at any time using its overriding powers under the NSL. If there is a military conflict over the Taiwan Strait, any commercial transactions or arbitration proceedings with companies from “hostile” foreign states are likely to fall within the PRC’s defi-

inition of “national security.”

If parties sign a contract today, disputes may not arise until several years down the line. The venue for resolving these disputes will present very sensitive issues for international companies. The political and legal landscape in Hong Kong will no doubt continue to change going forward. The Hong Kong government has already announced, with the incoming administration that began July 1st, that a new set of national security laws targeting foreign espionage, foreign organizations, “fake news” and cybersecurity will be enacted. These laws will be in place by the end of 2022 or early 2023. International companies need to take these developments into account and plan ahead.